Directorate of Intelligence

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Cuba: Hard Currency and Debt Problems

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An Intelligence Assessment

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Cuba: Hard Currency and Debt Problems [redacted]

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An Intelligence Assessment

This assessment was prepared by [redacted] of the Office of African and Latin American Analysis. Comments and queries are welcome and may be addressed to the Chief, Middle America–Caribbean Division, ALA, [redacted]

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Cuba: Hard Currency and Debt Problems [redacted]

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Key Judgments

Information available as of 14 April 1983 was used in this report.

Even with the partial rescheduling of Cuba's hard currency debt in March, we judge the Castro regime will have to deal with a prolonged economic crisis. Havana faces severe hard currency constraints over the foreseeable future—constraints that we believe will not only prevent it from meeting balance-of-payments targets established in the recent agreement with its Western creditors, but will have cascading effects throughout the economy.

For 1983 the picture is particularly bleak. Plunging sugar sales (the result of low world prices and recent heavy rains at home) and the weakening position of other exports together point to continued foreign exchange stringencies and declining national output—or, at best, no growth. Necessary import cuts will hit the domestic transport, construction, and power sectors and retard development of exports. For at least the next 10 to 12 months, Cuba's already austere standard of living will slip, as consumer goods become even scarcer and public health conditions decline because of shortages of pharmaceutical and sanitary equipment. The unrelieved grimness of life in Cuba, in turn, probably will translate into increased worker apathy and lower productivity, and in all probability the regime will have to contend with a more persistent black market and other low-level forms of social disorder.

We believe that beyond 1983 the outlook will—at best—brighten only slightly and nowhere near as much as billed in Cuba's recent presentations to its creditors. On the basis of our analysis of Cuba's hard currency import needs and debt service requirements, we expect that Havana will seek additional net credit from the West in 1984 and, perhaps, 1985, just to sustain modest economic expansion. Lender apprehension is likely to increase, however, so that even negotiations for future rescheduling will probably be more difficult. Such limited easing of financial pressures as takes place will depend on improvement in the sugar harvest from this year's setback and more largesse from an increasingly tough-minded Soviet leadership.

A logical—but, we judge, unlikely—course for the Castro regime to follow in dealing with the domestic consequences of this prolonged slump would be to allow greater individual initiative and rewards in order to help meet critical shortages and spur workers' productivity. Although a variety of reports and Cuban public announcements make it plain that there has been experimentation with market forces over the last few years, there is

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overwhelming evidence that Fidel and his early revolutionary comrades—still firmly in control—will resist any substantial or sustained moves in this direction. As a consequence, we believe that, on balance, Cuban "adjustment" policy will tend to deepen and extend the economic trough rather than offset it.

As Cuba's economic difficulties mount, the probability for heightened tensions with the United States will increase. In the past, Castro has consistently responded to serious domestic problems by placing the blame on Washington. In recent years, however, such appeals have become increasingly ineffective in mobilizing popular opinion, and the Cuban leader may feel compelled to manufacture a crisis with Washington in order to maintain his credibility. We cannot reliably forecast what form such a crisis might take, but options could include deliberate interference with US commercial radiobroadcasts, violations of US air traffic regulations by Cuban commercial aircraft, or a major diplomatic campaign against renewed US reconnaissance overflights.

Rather than place pressure on Castro to reduce his foreign adventures, we believe that the economic difficulties of the next few years will stimulate the Cuban leader to expand them. One factor favoring this is that the stationing of large numbers of civilian or military personnel abroad helps reduce the island's labor surplus problems somewhat. This vent also sustains the positive atmosphere among youth created by the awarding of special benefits for overseas service. Beyond these domestic pressures, increasing financial dependence on Moscow will entail more opportunities for Cuba to be pressed into Soviet overseas activities.

Should the government fail to stimulate more rapid growth in the second half of the 1980s, we believe that the probabilities of more profound changes in key Cuban foreign relations would rise appreciably. Cuba's growing labor surplus could, for example, cause the leadership to spur another large population exodus to the United States. Moreover, Havana's inability to put its economic house in order could cause the Soviets to demand greater control over the island's economy.

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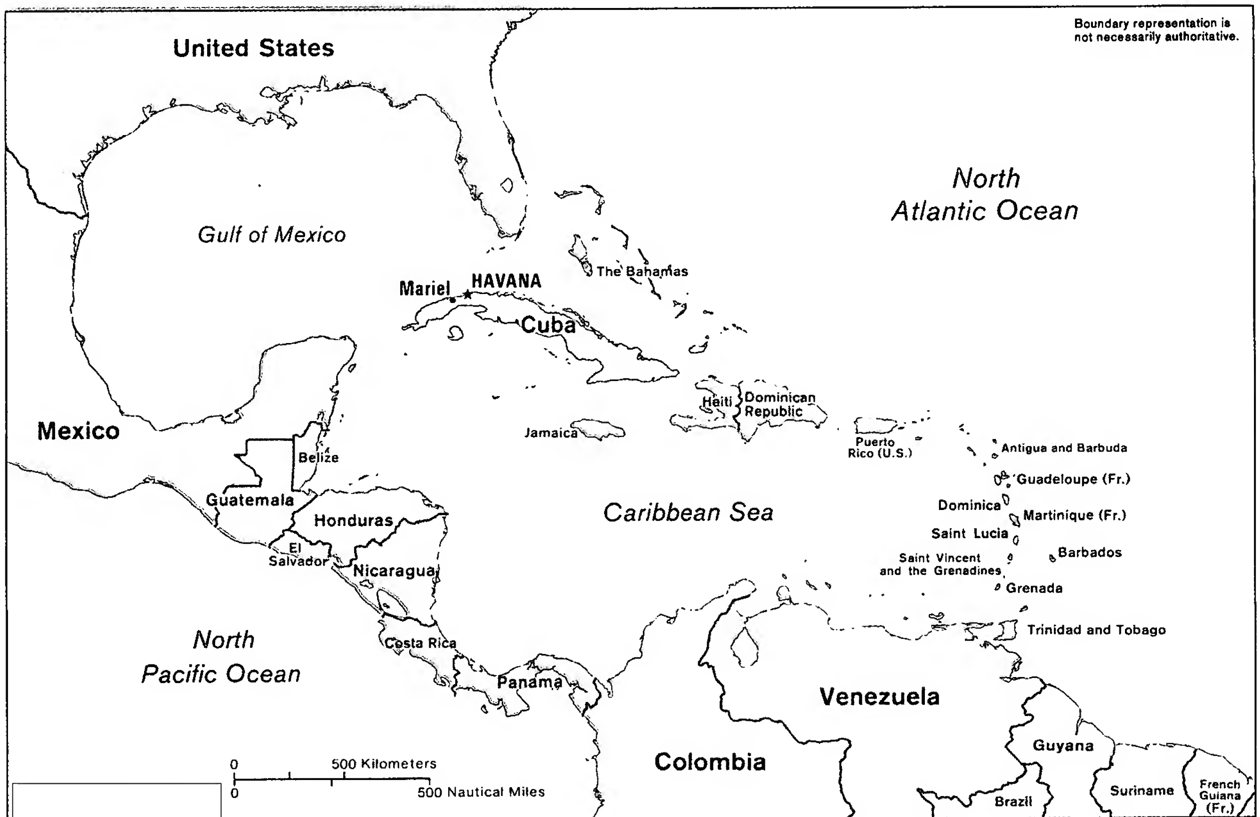

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Cuba: Hard Currency and Debt Problems [redacted] 25X1

Introduction

Cuba has frequently encountered hard currency problems, primarily because it depends heavily on sugar for its foreign exchange earnings. Even so, European and Japanese creditors have generally considered it a good credit risk because of its conservative financial management and good repayments record. During the past two years, however, a steep drop in world sugar prices coincided with increased lender wariness to Third World and Communist countries and vigorous US lobbying against foreign lending to Cuba. These three factors decreased Havana's attractiveness to foreign lenders and propelled the Cubans into a hard currency crisis. By mid-1982, the Castro regime had slashed imports and requested—for the first time—a rescheduling of part of its external debt. These accumulating stresses came at a time when Cuba faced dim market prospects for its exports and a leveling off of Soviet economic assistance. [redacted]

This paper examines the trade adjustments Cuba is making in response to its foreign exchange bind and the effects of these adjustments on producers and consumers alike. The paper also assesses Cuba's options to manage its debt through 1985 and the foreign policy implications of Cuba's worrisome economic condition. [redacted]

The Beginnings of Stress

Havana's vulnerable economy began to wane in late 1980 with the plummeting in the world price of sugar—the source of over half of Havana's hard currency export earnings—and a sharp rise in debt service requirements. Constrained by export restrictions imposed by the International Sugar Organization in the face of declining global consumption and rising world production, Cuba was—according to a number of trade journals—unable to increase the volume of world market sugar sales enough to offset an 80-percent drop in prices between October 1980 and mid-1982. Increased hard currency sugar purchases by Soviet-aligned countries and earnings from Havana's other major sources of foreign exchange—nickel, seafood, tobacco, tourism, and construction services—did not fill the gap. By 1982, as a result of sagging exports and high interest rates, Cuba faced debt service obligations (principal and interest) on its foreign debt equivalent to nearly half of its hard currency earnings for the year. [redacted] 25X1

As the situation worsened, Havana undertook a variety of measures to deal with its severe hard currency shortages. Official Cuban data indicate a reduction in nominal imports of about 30 percent in 1982 from 1981 levels. Havana also cut other hard currency expenses, such as embassy budgets. Furthermore, [redacted] attempts were 25X1 made to raise new funds on the international financial markets and to roll over old loans as they became due. [redacted] 25X1

These measures proved both insufficient and domestically costly. The import cuts reduced the current 25X1 account deficit, but slowed economic activity. For example, even according to Cuban reports economic growth dropped to about 3 percent in 1982 from over 10 percent in 1981, in large part because vital inputs to basic industries such as construction and steel were 25X1 reduced. [redacted] 25X1

Moreover, the measures failed to impress Western financial institutions. New loan requests were denied. In addition, short-term credits were withdrawn as international bankers—fearing that the USSR would not guarantee Cuba's growing debt and seeing vigorous US lobbying against lending to Cuba—became more wary. [redacted] 25X1

Lacking sufficient inflow of funds, foreign exchange reserves were drawn down to cover immediate financial obligations. Official Cuban figures showed reserves dropping from over $400 million at the end of

1981 to $155 million by mid-August 1982, equivalent to about six weeks' imports at the 1981 rate.

In late August 1982, Havana formally requested a rescheduling of part of its debt. We believe a number of considerations prompted the Cuban decision:

- Havana may have wanted to obtain help before growing numbers of financially strapped LDCs sopped up available international funds.

- The looming scheduled repayment of principal on a large portion of its hard currency debt heightened Cuba's concern. Havana almost certainly understood that it needed to do something quickly before its rapidly weakening financial position and creditworthiness deteriorated even more.

- The government also believed—a point admitted in Fidel Castro's nationally televised speech of 26 July 1982—that, with sugar prices unlikely to recover soon and prospects for Cuba's other exports poor, the country faced further import retrenchment.

Moreover, we believe Havana also realized that Moscow was unlikely to provide enough hard currency to redress Cuba's problems. Subsequent reporting by the US Embassies in Paris and London indicated that Cuban officials admitted to creditors and diplomats that the USSR could not solve their debt problems. In addition, the US Embassy in Moscow reported that, although Cuba's hard currency indebtedness was a topic of discussion during Raul Castro's visit in January 1983 to the USSR, Soviet officials did not offer Havana any assistance. On the basis of Soviet advice to its East European clients in similar circumstances, we believe that Moscow encouraged the Cubans to be relatively cooperative with Western creditors during the rescheduling talks, recognizing that a hardline approach by Havana could sabotage the sessions and leave Moscow holding the bag.

The Debt Rescheduling Exercise

According to statistics that Cuba released to its creditors, its total hard currency debt is about $3.2 billion. Over half of the debt ($1.7 billion) is held by private institutions, primarily as short-term deposits ($1.1 billion) and medium- and long-term bilateral and consortium loans ($532 million). The remainder is held by official creditors, mainly as export credits ($1.2 billion) and intergovernmental loans ($240 million). The countries with the largest exposure (in million US $) are: 25X1

Spain	406	Argentina	206
France	392	Switzerland	131
Japan	376	Canada	109
United Kingdom	234		

Nearly 60 percent of the total debt was originally scheduled to be repaid by the end of 1983. 25X1

Havana's rescheduling request was restricted to the $1.3 billion of its medium- and long-term hard currency debt that was scheduled to fall due between September 1982 and December 1985. Officially guaranteed export credits accounted for two-thirds of this amount, while syndicated and bilateral loans made up the remainder. Copies of the Cuban proposal indicate that Havana requested liberal terms; principal payments due from September 1982 through 1985 were to be stretched over a 10-year period, including three years' grace. Havana proposed to pay interest and administrative costs on schedule, and asked that letters of credit continue to be honored and short-term credit facilities remain open. Moreover, it sought bilateral negotiations with each creditor and—unrealistically—expected that the whole process would be completed by December 1982. 25X1

In a matter of weeks, officials of the Cuban National Bank (BNC) had visited all major Western creditors as well as many minor ones. According to the US Embassy in Tokyo, Cuban officials attempted to secure bilateral agreements from individual creditor nations by claiming falsely that others had already agreed to such arrangements. In our judgment, this was an attempt to secure more liberal terms, avoid 25X1 pressures to institute an economic recovery program, and—perhaps—prevent political conditions from being attached to the exercise. Cuba's stratagem failed, however, as Western creditor nations, faced with the prospect of several massive debt reschedulings in the near future, were unwilling to set an undesirable

Table 1
Cuba: Foreign Debt in Freely Convertible Currency and Projected Maturity

Million US $

	Total	Sep-Dec 1982	1983	1984	1985	1986	1987	1988	1989	1990	Rest
Total debt owed [a]	3,219.6	1,033.2	790.9	438.1	338.6	252.4	145.6	78.4	41.7	32.8	67.9
Bilateral public debt	1,478.8	118.2	341.6	294.6	220.8	191.9	122.1	58.9	34.2	31.1	65.3
Intergovernmental loans	239.3	0	35.3	35.3	35.4	53.8	28.9	12.6	12.6	12.4	13.1
Development aid credits	34.9	0.2	0.7	1.0	1.4	1.4	1.4	1.6	1.6	1.7	23.7
Export credits guaranteed by the state	1,204.8	118.0	305.6	258.3	184.0	136.7	91.8	44.7	20.2	17.0	28.5
Multilateral public debt	21.0	0	2.8	2.3	3.7	3.7	3.7	3.7	0.1	0.1	1.0
Suppliers credits	33.1	3.5	10.2	10.8	7.0	1.6	0	0	0	0	0
Financial institutions	1,686.0	911.2	436.2	130.3	107.0	55.2	19.8	15.8	7.4	1.6	1.6
Bank loans and deposits	1,619.6	894.5	392.4	124.4	107.0	55.2	19.8	15.8	7.4	1.6	1.6
Medium-term bilateral and consortium loans	531.6	41.8	157.1	124.4	107.0	55.2	19.8	15.8	7.4	1.6	1.6
Short-term deposits	1,088.0	852.7	235.3	0	0	0	0	0	0	0	0
Current import credits	66.4	16.7	43.8	5.9	0	0	0	0	0	0	0
Other Credits	0.7	0.5	0.1	0.1	0.1	0	0	0	0	0	0

[a] Includes short-term obligations as of 31 August 1982; assumes a constant US $:Cuban peso exchange rate at the 1982 level of 1.2:1.

[redacted] 25X1

precedent. Instead, they demanded the usual multilateral forum and requested guidance by the Paris Club. [redacted]

In September, the Paris Club creditors' caucus agreed on a quasi–Paris Club formula (similar to that devised for Poland) to be chaired by France.[1] Instead of oversight by the International Monetary Fund (IMF), a task force composed of five of the largest creditors—Spain, France, Japan, Sweden, and Italy—was formed to analyze and monitor Cuba's performance. [redacted]

The task force met in Havana during early November to discuss the BNC report, to press for an economic recovery plan, and to obtain additional data. Reporting from the US Interests Section in Havana indicates that the Cubans tried in a variety of ways to deflect requests by the creditors for policy changes and additional data, but were largely unsuccessful. Besides using several ploys that demonstrated a mix of naivete and cunning, Fidel Castro personally met with the creditors to dissuade them from requiring an economic recovery plan. [redacted] 25X1 25X1

Reporting from the initial creditors' caucus held in late November reflected considerable differences among the creditor countries over the merits of the Cuban position. The US Embassy in Paris reported that most creditors not on the task force initially took a relatively hard line, questioning the prospects for Havana's implementing a sound economic adjustment program. The United Kingdom, Canada, and West Germany even questioned the need for a rescheduling, citing their belief that the problem was merely a short-term liquidity crisis, primarily with private 25X1

[1] Cuba was prevented from receiving formal Paris Club proceedings because it is not a member of the International Monetary Fund. [redacted] 25X1

Non-Paris Club Official Creditors

Cuba's appeal to non–Paris Club creditors for debt renegotiation has centered on Argentina ($206 million) and OPEC nations ($278 million in medium- and long-term debt). Cuba places its total debt to "oil-exporting countries and others" (no further breakdown available) at over $1 billion, with the majority ($765 million) being short-term loans and thus not part of the amount to be rescheduled. [redacted]

Cuba completed the renegotiation of its debt with Argentina in September, [redacted] *Argentina apparently agreed to reschedule on the terms requested by the Cubans, probably as a result of increased political affinity following the Falkland Islands conflict.* [redacted]

In addition, Cuba sent a central bank mission to Kuwait last November, probably to try to secure a similar agreement. We have no reporting on the outcome of this effort. The US Embassy in Kuwait reported, however, that the Cuban Bank officials were also trying to obtain additional short-term loans from the Kuwaiti Central Bank. [redacted]

Rescheduling Terms and Conditions

As a result of the March 1983 agreement, 95 percent of Cuba's medium- and long-term principal due from September 1982 to December 1983 was rescheduled for eight years, including a three-year grace period. The creditors established the following convertible currency performance targets for the end of 1983 in place of a traditional IMF-stabilization program (amounts expressed in US dollars assuming a US $: Cuban peso exchange rate at the 1982 level of 1.2:1): 25X1

- *Minimum trade surplus of $410 million.*
- *Current account surplus of $6 million.* 25X1
- *Short-term debt minimum of $1.1 billion and maximum of $1.2 billion.* 25X1
- *Maximum total debt of $3.4 billion.*
- *A minimum of $180 million and maximum of $360 million in the foreign exchange reserves.* 25X1
- *Real growth rate of economy of 2.0 to 2.5 percent.*

[redacted] 25X1

To assure compliance with these targets, the task force mandated a monitoring system consisting of quarterly economic reports to be released by Havana and a semiannual review by the creditors. Provision for rescheduling principal due in 1984 was linked to Cuba's compliance with the targets. [redacted] 25X1 25X1

banks. Other creditors (Spain, Italy, Switzerland, Belgium, and Sweden), who were motivated by political ties or feared a Cuban default, wanted to move quickly toward agreement. [redacted]

By January, according to the US Embassy in Paris, the creditors began moving steadily toward a consensus, as the United Kingdom, Canada, and West Germany softened their positions because they feared a breakdown of the traditional multilateral approach of handling debt renegotiations. A rescheduling agreement was signed in early March 1983. [redacted]

Economic Impact of Hard Currency Shortages Through 1985

In our view, Cuba has in store more hard currency shortages, and these will further weaken an economy already confronted with difficulties greater than at any time since the revolution.[2] Sugar prices are unlikely to rise markedly in the near future as world production is widely forecast to continue to remain high in the face of slack demand. Moreover, with Moscow's own hard currency resources dwindling, Castro faces the prospect of little or no real growth in Soviet aid. The adjustments Havana must make will cause economic growth and consumer welfare to suffer significantly. We do not believe, however, that they will inspire more liberal economic policies to spur productivity or minimize hardships. [redacted] 25X1 25X1 25X1 25X1

[redacted]

Cuba Spars With the Creditors

The three-day Havana debt negotiations last November got off to a rocky start as the Cubans refused to provide basic economic data requested by the task force, claiming that they were state secrets. The situation was made worse by the fact that they had not prepared a recovery plan on the grounds that such a plan would infringe on Castro's powers. [redacted]

[redacted]

[redacted] 25X1

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[redacted] 25X1 *Reporting from the US Interests Section in Havana indicates that Castro implied to several Western ambassadors that the rescheduling exercises presented an "opportunity" for Western Europe to bridge the Cuban-US impasse. Another tactic used by the Cubans was to claim in documents and speeches to creditors the existence of newly discovered domestic oil sources; Havana has used this gimmick on previous occasions, but the findings of earlier geological studies do not support such claims.* [redacted] 25X1 25X1

According to the US Embassy in Paris, the task force insisted on limiting the discussions to economic and financial matters and perforce was able to acquire some additional relevant data from the Cubans. The Cuban "recovery program" that was subsequently released, however, does not constitute what is normally required by the Paris Club as a condition for rescheduling. In our judgment, it does not represent a set of plans to allocate resources or to assume achievement of targets; it is merely an exhortation to increase production and exports through greater sacrifice and work by the Cuban people. [redacted] 25X1

Trade Adjustments
The economic program designed by the Castro regime at the time of the rescheduling discussions has, expectedly, two key features: keeping the level of convertible currency imports as low as possible, and expanding exports that earn hard currency. [redacted]

Cuban Import Expectations. Cuban projections, as presented to the creditors, envisage a gradual buildup in hard currency imports, but even in 1985 the projected level would still be nearly 15 percent below the 1981 level in real terms. Imports of capital investment and consumer goods are to receive low priority, while imports of raw material and intermediate goods necessary for production of exports will be emphasized. [redacted] 25X1 25X1

[redacted] 25X1

As a first rule of import rationing, Havana has stated that it will import only essential items. Even so, we believe this will do little to conserve hard currency because the overwhelming majority of imports from

Table 2
Cuba: Hard Currency Merchandise Imports and Exports, 1978-85 [a]

Million US $

	Export (f.o.b.)	Imports (c.i.f.)
1978	882.8	971.2
1979	1,020.9	885.0
1980	1,809.8	1,425.5
1981	1,719.5	1,264.4
1982 [b]	1,629.4	880.3
1983 [c]	1,419.8	1,050.5
1984 [c]	1,526.5	1,157.8
1985 [c]	1,623.2	1,167.6

[a] Cuban projections released by Banco Nacional de Cuba to creditors. Our forecast differs—see table 4.
[b] Estimated.
[c] Projected, assuming a US $:Cuban peso exchange rate at the 1982 level of 1.2:1.

[redacted]

non-Communist countries is considered essential by Havana. Machinery and transport equipment, basic manufactured goods, and food make up the bulk of these imports; few consumer goods are imported overall and most of these come from Communist countries. Nearly all machinery, transport, and basic manufactured imports are for industrial use; virtually no passenger vehicles, office machinery, and household equipment are purchased with hard currency.[3] Hard currency food imports primarily comprise wheat, wheat flour, vegetables, powdered milk, butter, and animal feeds. [redacted]

Imports of nonessentials in other categories also are negligible. Most chemical imports consist of dyes, plastics, insecticides, herbicides, and medicines, while imports of perfumes, cosmetics, and soaps account for about $5 million (or less than 3 percent of hard currency chemical imports). Goods vital to public health, such as medical instruments and sanitary and plumbing fixtures, account for about one-half of miscellaneous manufactures imports. [redacted]

[3] Major items imported for industrial use include electric power generating machinery, engines, pumps, centrifuges, spare parts, railway vehicles, buses, trucks, rubber, textile yarn, thread, fabrics, clay construction materials, iron and steel bars, rods, plates, sheets, pipes, and fittings, finished structural parts, nails, screws, nuts, bolts, rivets, and worked copper. [redacted]

Cuban Exports Projections. Cuba's optimistic plans to increase its foreign exchange earnings through 1985 focus on expanding its nonsugar hard currency exports, particularly of tobacco, with a projected 150-percent increase, and of fish and nickel, each with projected increases of 40 percent. By contrast, sugar earnings are projected—reasonably in our judgment—to remain relatively low, assuming only a slight recovery in the world market by 1985. [redacted] 25X1

Cuba does not project its service account—which, even excluding interest payments, was in deficit for most of 1978-82 due to exchange rate adjustment and transportation expenses—to recover significantly during the next three years. Limited increases in revenues from tourism and technical assistance programs will barely offset rises in transportation expenses and declines in earnings from ship chartering. [redacted] 25X1

CIA Judgments. On balance, we believe that these projections are too optimistic. We forecast—based on Cuban import projections, our own export projections, and consideration of debt service—that Havana's current account balance will be deeply in the red in 1983 and 1984. Crop damage caused by severe weather early this year will reduce sugar and tobacco exports in 1983. Beyond 1983, exports should increase somewhat because of renewed policy emphasis on them and the fact that some new plants will be coming on stream. Even this recovery in exports would not be sufficient, however, to cover import needs and interest payments in 1984. A meager current account surplus is possible in 1985 if—as we expect—slight export price rises help bring earnings back to 1982 levels. [redacted] 25X1 25X1 25X1

The key constraining factor in spurring export growth during this period will be the material shortages that arise from import cutbacks. [redacted] 25X1 25X1

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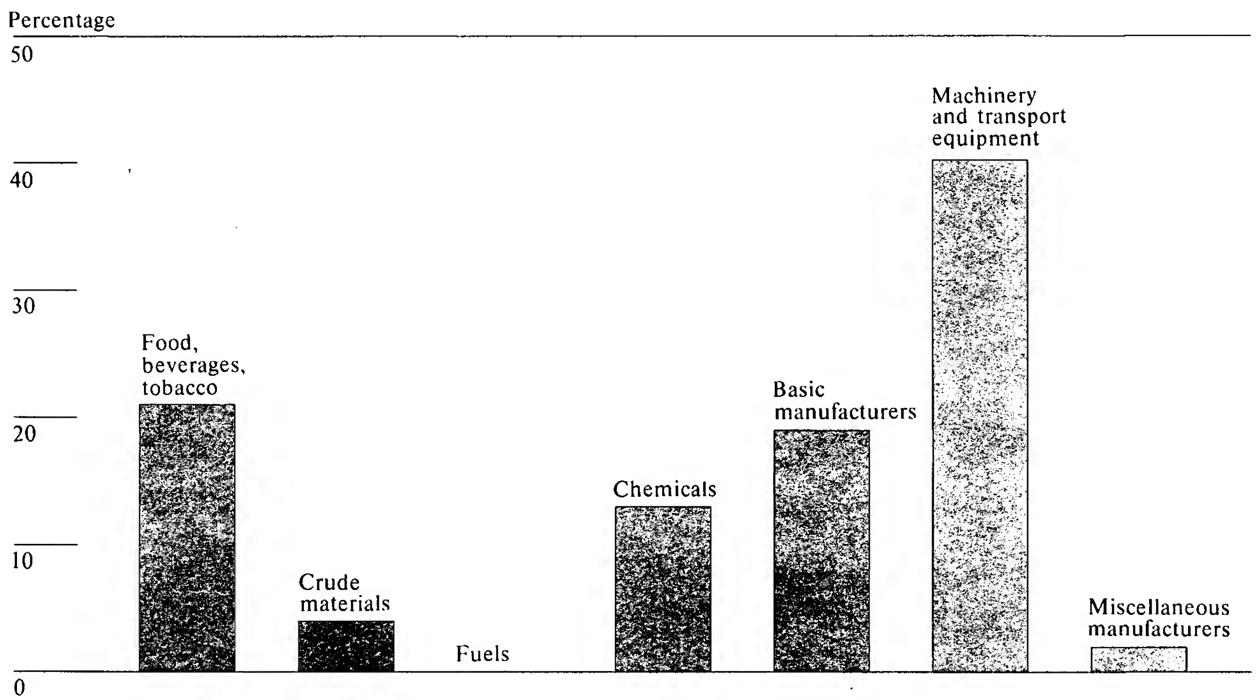
Cuba: Composition of Hard Currency Imports, 1981



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The immediate impact of these and other import cuts will be reduced production in certain key industries that support production for export. Products most likely to be affected include electric cables, heavy equipment for the construction industry, irrigation systems, and spark plugs and other spare parts. [redacted] Cuba's largest domestic producer of irrigation systems, which closed last summer, is unlikely to reopen on a full-scale basis any time soon. In addition, [redacted] suspended Japanese financing for raw materials used to produce batteries and electric motors used by the sugar industry will cause lower output in those areas also. Other industries probably will be forced to reduce production because of delays in taking delivery of imports from Japan, Canada, the United Kingdom, West Germany, and other non-Communist nations. [redacted] 25X1

Havana has emphasized that it will try to protect its export industries from input shortages, but we believe there are serious limits to what it can do. Output of 25X1 sugar, nickel, citrus, and tobacco will be the easiest to shield in the short term. The effects of long-term hard currency shortages could spill over into these sectors 25X1 within several years, however, if herbicide and irrigation applications are reduced, critical machines or parts are in short supply, or equipment maintenance is 25X1 postponed. Furthermore, the cuts in the key transport and construction sectors will affect these and the other sectors of the economy. [redacted] 25X1

Table 3 *Million US $*
Hard Currency Earnings Projected by Cuban Government, 1978-85 [a]

	1978	1979	1980	1981	1982 [b]	1983 [c]	1984 [c]	1985 [c]
Total	**882.8**	**1,020.9**	**1,809.8**	**1,719.5**	**1,629.4**	**1,419.8**	**1,526.5**	**1,623.2**
Sugar	489.3	554.9	1,178.9	1,068.3	795.4	386.9	496.8	621.0
Hard currency purchases by Socialist countries [d]	139.5	151.1	0	187.8	382.8	0	0	0
Nonsugar	370.9	463.4	495.1	442.7	618.0	691.4	766.7	788.3
Tobacco	73.4	68.9	48.0	69.2	141.5	146.0	169.2	174.0
Fish	113.2	134.0	127.5	125.8	118.3	160.4	168.6	176.4
Nickel	65.3	80.4	79.8	75.0	79.6	84.0	108.0	108.0
Naptha	38.4	74.4	101.5	20.0	78.1	80.4	80.4	80.4
Coffee	28.6	30.4	30.7	36.4	36.2	44.4	54.4	54.4
Citrus	0	0	0	0	3.6	7.6	8.8	9.1
Other	52.0	75.3	107.6	116.3	160.7	168.6	177.3	186.0
Reexports [e]	22.6	2.6	135.8	208.5	216.0	341.5	263.0	213.9

[a] The data in this table are official Cuban statistics released to creditors in late 1982. Our estimate for 1982 and projections for 1983-85 differ—see table 4.
[b] Estimated.
[c] Projected, assuming a US $:Cuban peso exchange rate at the 1982 level of 1.2:1.
[d] Purchased by the USSR and China at the market price on a spot basis.
[e] Reexports are all to nonmarket economies and since 1981 are composed primarily of oil that Cuba was successful in saving.

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Economic Stagnation

Cuba's 1981-85 Five-Year Plan—drafted in 1980 against a backdrop of the high world market sugar prices—envisioned average annual real growth, as measured by gross social product (GSP), of 5 percent.[4] Major increases in production were predicted throughout the economy, particularly in electric power generation (50-percent increase), steel output (to rise by 600 percent), and housing construction (100-percent rise).

[4] The Cuban measure of economic output—gross social product—counts the value of goods and services at all stages of production, a procedure that results in significant double counting. It is difficult to specify how growth projections based on this system would translate to equivalent Western measures. The key issue in this analysis, however, is not the correlation between Communist and Western measures but rather the Cubans' expectation of substantial real growth.

Partly because of the hard currency shortage, Havana, in our opinion, has little hope of achieving these targets, and this year will probably experience declining national output—or, at best, no growth. Sagging construction activities will thwart Cuban efforts to build new sugar mills, hotels, electric power plants, and similar projects. In addition, capital equipment will be hard to replace or repair, and increasing numbers of factories—particularly in the nonexport sectors—will be forced to close or reduce operations. Moreover, crop losses resulting from weather damage early this year will be an additional limiting factor on output.

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Table 4
Cuba: Hard Currency Current Account Balance [a]

Million US $

	1978	1979	1980	1981	1982	1983	1984	1985
Merchandise trade balance	−88.4	135.9	384.3	455.1	623.8	15.9 to 65.9	139.2	382.7
Exports	882.8	1,020.9	1,809.8	1,719.5	1,513.1	1,066.4 to 1,116.4	1,297.0	1,550.3
Imports	971.2	885.0	1,425.5	1,264.4	880.3	1,050.5	1,157.8	1,167.6
Service account balance	−498.1	−237.6	−578.7	−304.3	−430.9	−404.8	−412.2	−361.4
Service earnings	223.0	404.1	340.2	440.1	318.4	286.0	318.0	375.6
Service expenditures	721.1	641.7	918.9	744.4	749.3	690.8	730.1	737.0
Interest	190.4	243.0	371.4	432.4	413.9	406.3	417.4	433.8
Current account balance	−586.5	−101.7	−194.4	150.8	201.9	−388.9 to −338.9	−272.9	21.3

[a] Data for 1978-81 are from Cuban sources. Merchandise export earnings for 1982-85 are CIA estimates and differ from Cuban projections. All other forecasts (imports, service earnings, and expenditures) are Cuban projections, which we believe are reasonable. The Cubans assume, as we do, that debt falling due in 1984-85 will be rolled over with the acquiescence of Western bankers.

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We believe the economy will recover from this year's weather-related damages in 1984 but that subsequent growth—at least through 1985—will still be constrained by hard currency shortages. Although we believe the production for export will increase over this period, Havana will face poor market prospects for its traditional key foreign exchange earners, largely because international prices of sugar and nickel will—in the judgment of most commodity analysts—remain depressed due to large world stocks.

We believe that the foreign exchange constraint will continue to limit investment options and growth in 1984-85. Some projects and activities will be adapted to allow a still greater proportion of inputs from other Communist countries. Even so, for the reasons we detail below in discussion of financing options, we do not expect Moscow to make up all of the gap in hard currency—or equivalent imports—needed to assure a strong Cuban economic resurgence.

Increased Consumer Austerity

We judge that the already Spartan standard of living in Cuba will be reduced further during 1983-85 as a result of the hard currency shortage and related economic stagnation. In his remarks to the creditors, Castro described his intentions to cut domestic consumption. Moreover, during the past year, the Cuban Government has been preparing the population for tougher times through speeches and newspaper articles urging Cubans to work harder and sacrifice more.

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The availability of consumer goods undoubtedly will dwindle. Production of items such as refrigerators and color television sets that require hard currency imports probably has been cut back already. Moreover, imports of such consumer items from Communist countries also may be reduced if the regime attempts to increase imports of raw materials, intermediate goods, and capital equipment from Eastern Europe and the USSR to substitute for decreases in imports of these goods from the West.

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Table 5
Cuba: Hard Currency Earnings, 1982-85 [a]

Million US $

	1982	1983	1984	1985
Total	1,513.1	1,066.4 to 1,116.4	1,297.0	1,550.3
Sugar [b]	795.4	350 to 400	528.0	771.4
Hard currency purchases by socialist countries [c]	382.8	0	105.6	242.4
Nonsugar	501.7	506.4	605.8	646.9
Tobacco	84.0	60.0	96.0	108.0
Fish	118.3	138.0	150.0	162.0
Nickel	79.6	64.8	93.0	96.9
Naptha	60.0	60.0	60.0	60.0
Coffee	36.2	44.4	54.4	54.4
Citrus	3.6	7.2	8.4	9.6
Other	120.0	132.0	144.0	156.0
Reexports [d]	216.0	210.0	163.2	132.0

[a] Assumes a US $:Cuban peso exchange rate of 1.2:1 for 1982-85.
[b] Weather-related crop damage probably will limit Cuba's sugar exports to the West to 2.2 million metric tons at best in 1983. Assumes world price this year of 7 to 8 cents per pound. Beyond 1983, assumes quota sales of 2.4 million metric tons are met and prices are 8 and 10 cents per pound in 1984 and 1985, respectively.
[c] Projected as surplus crop (after all other export commitments and domestic consumption are met) at the market price.
[d] Our projections call for reexports significantly smaller than Cuba forecasts, owing to lower oil prices. (Nearly all reexports are oil.)

[redacted]

Food supplies could also be affected, especially on top of political measures taken in recent months to restrict farmers' free markets.[5] Most of Cuba's food imports are soft currency purchases, but Havana depends on convertible currency imports for some of its wheat, powdered milk, beans, and animal feeds. [redacted] Cuba was facing critical shortages of animal feeds because of the lack of hard currency. These shortfalls will cause decreased production of meat and dairy products. [redacted] 25X1

[5] The farmers' free markets, opened in mid-1980, permit private farmers to sell any production in excess of state quotas in markets where the price is determined by supply and demand. Although the availability of the markets has stimulated agricultural output, they are anathema to Castro. As demonstrated in his speeches on the subject, he considers that they conflict with revolutionary ideals by promoting the growth of an entrepreneurial class. The government arrested several hundred people in a crackdown on the markets in mid-1982 and subsequently implemented regulations that have restricted operations. [redacted] 25X1

The shortages of consumer goods and food could cause attendant problems with workers. Havana has attempted to offset food shortages by expanding the parallel state-run market system, in which consumers are offered foodstuffs and a limited assortment of consumer goods at high prices. We believe it unlikely, however, that pent-up demand for consumer goods and foodstuffs will be met by the new government markets. As a result, workers will have insufficient economic incentive to improve their productivity. Over the short term, absenteeism is likely to increase, and product quality will decline even further. Because of excess liquidity, Cuban citizens increasingly will look to the black market to satisfy their demand for consumer goods. [redacted] 25X1

Health problems also may arise from the current economic crisis. Havana imports medicines and pharmaceutical raw materials from the West valued at $20-30 million annually, in addition to the medical and sanitary equipment noted above. [redacted] 25X1
[redacted] the Castro government has 25X1
compiled a list of "nonessential" medicines, which will no longer be imported. The lack of a sophisticated pharmaceutical industry, however, implies that such actions could result in increased incidence of diseases in a country that has recently been plagued by outbreaks of dengue fever and hemorrhagic conjunctivitis. 25X1 [redacted] 25X1

Economic Policy Responses

The deteriorating economic situation is likely to renew debates within the Cuban leadership over economic policy. We believe pragmatists and technocrats will argue for greater emphasis on material incentives, 25X1 removing selected restrictions on private enterprise 25X1 activities, and delegating greater planning authority to enterprise managers. Hardline elements, who currently dominate the leadership, will strongly oppose such proposals and opt for increased repression to handle any dissent. [redacted] 25X1

Table 6
Cuba: Economic Dependence on Hard Currency Imports [a]

Economic Sector	Hard Currency Imports
Foreign exchange earners	
Sugar	Herbicides, pesticides
	Raw materials for production of irrigation equipment
	Automated components for modern sugar mills
	Raw materials for production of sugar syrup tanks
Nickel	Some spare parts for nickel plants of US origin
	Special trucks to carry nickel from mines to plants
Tobacco	Herbicides
Citrus	Some Western herbicides and irrigation equipment
Fishing	Boats
	Spare parts
	(Hard currency also required for leasing ships, in port repair, and fuel costs.)
Tourism	Raw materials for construction of hotels
	Hotel equipment
Miscellaneous manufactured goods	Spare parts, equipment
Overseas construction	Spare parts, equipment
Goods for domestic consumption	
Agriculture	Seeds
	Pesticides
	Irrigation equipment
	Miscellaneous agricultural implements
Miscellaneous manufactured goods	Textiles and raw materials for textile production
	Parts and materials for color television production
	Components for production of refrigerators and air conditioners
Domestic services	
Transportation	Trucks
	Buses
	Miscellaneous spare parts or raw materials for manufacture of spare parts including:
	Batteries
	Spark plugs
	Tires
	Components for railroad system
Electric power	Some spare parts and equipment (most come from USSR)
Construction	Spare parts
	Equipment
	Raw materials
Health	Pharmaceutical raw materials
	Medical instruments

[a] The paucity of data regarding Cuban domestic production capabilities and imports from CEMA prevents quantification of dependence on these imports.

In the near term, we believe that the regime will at best implement only a few token reform measures. Castro and the hard liners probably will hold to the view that any measures smacking of economic liberalization run the risk of creating a ground swell of demands for more. Despite the success of the farmers' free markets instituted in 1980, the regime sharply restricted their activities last year, criticizing the appearance of "nonproductive middlemen" as proof of the invidious effects of private enterprise experiments. Moreover, the events in Poland probably have strengthened even further Castro's antipathy for ideological deviation. [redacted]

The Cuban leader demonstrated in his meeting with the creditor task force that his concept of structural adjustment involved only additional tightening of the belt. He apparently has concluded—correctly in our view—that increased austerity will not create a popular backlash against his authority in the near future. The vast majority of Cuban citizens recognize that any acts of overt opposition would be quickly crushed by the highly efficient security forces, whose incomes and living standards historically have been protected. [redacted]

Further Rescheduling and Financing Problems

Our analysis of Cuba's economic prospects assumes that Havana will meet remaining short-term financing needs for 1983 and will be able to secure rescheduling of existing hard currency debt that falls due in 1984-85. We—and the Cubans—believe that the Western banks, which continue to receive interest payments, will see this as the best way to protect their equity. Should the rescheduling exercises be unsuccessful, economic problems could worsen substantially. [redacted]

Although the grace period on repayments of medium- and long-term debt has been extended through 1985 as Havana requested, Cuba would need to obtain significant new short-term financing in 1983 and 1984 to import even the reduced amounts it has forecast. It will be restrained from doing so, however, by the $3.4 billion limit on total debt—only $200 million above current indebtedness—set in the rescheduling agreement. Cuba cannot afford to cut further into its reserves, which probably are less than the $180 million minimum—equivalent to nine weeks' import cover at 1982 levels—established in the rescheduling agreement. [redacted] 25X1

Financing for 1983 will be particularly tricky because $235 million in short-term deposits falls due this year. Western press reports indicate that Cuba is seeking to roll over these deposits, but is meeting some opposition from private bankers. In recent months it has unilaterally assumed that its credits have been extended and has placed new orders, [redacted] 25X1 We believe Havana may 25X1 need to ask bankers to stretch out repayments of short-term debt if it is unsuccessful in rolling them 25X1 over. [redacted] 25X1

Cuba already has publicly indicated that it will request a rescheduling of principal falling due in 1984. On the basis of our current account projections, such action will be necessary. Because Havana is unlikely to meet the balance-of-payments and growth targets set in the rescheduling agreement, it probably will find negotiations more difficult next year. [redacted] 25X1 25X1

Havana cannot count on the USSR to provide the necessary foreign exchange to alleviate its problems. According to Cuban Government publications, Moscow has eased Cuba's problems somewhat in recent years by purchasing some sugar for hard currency and permitting Havana to resell, for foreign exchange, Soviet-provided oil that it has been able to conserve. It is unlikely, however, that the Soviets will significantly increase this form of assistance owing to their own convertible currency stringencies. [redacted] 25X1

Cuba has indicated to its creditors that it plans to integrate its trade further into the Soviet Bloc economic system in order to decrease its dependence on 25X1 hard currency imports. Havana's ability to accomplish this is hampered by the immediate need to earn convertible foreign exchange to service its debt and to purchase imports unavailable from the USSR or its allies. Moreover, even if the strategy of further integration takes hold, subsidies from Moscow for Cuban

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sugar exports and oil imports significantly greater than 1982's $3.8 billion are unlikely.[6] While we have no reports that Moscow is planning to reduce subsidies to Cuba, we believe a leveling off is likely because of the substantial opportunity costs for Moscow. (The USSR already has reduced subsidized oil deliveries to East Germany, Czechoslovakia, and Hungary.) Moreover, Soviet officials occasionally have complained that Cuba wastes much of the aid it receives. A reduction in subsidies will decrease Cuba's ability to import from the Soviet Bloc, thereby increasing the amount of hard currency imports needed to maintain even modest economic growth.

Cuba is unlikely to attempt to divert its soft currency trade into hard currency markets. It is constrained from doing so by:

- Its quota of sugar exports to the West of 2.4 million metric tons established by the International Sugar Agreement.
- Multilateral agreements with the USSR and its allies, which specify that the major portion of future output of new nickel and citrus processing plants be exported to the East in return for assistance in constructing and modernizing these sectors.

Implications for the United States

Cuba's sluggish economy will have some substantial implications for its foreign policy over the next three years. Havana's first response to its hard currency difficulties probably will be a reorientation of its shrinking trade with Western nations. Japan's refusal to provide new export credits and export insurance already has spurred the Cubans to increase their purchases from more sympathetic countries—such as Spain—that are willing to provide guaranteed credits. In Latin America, Havana is attempting to use the opening created by the Falklands crisis to acquire liberal credit arrangements with nations such as Argentina and Peru. 25X1

The Castro regime probably expects the United States to take advantage of Cuba's financial problems by pressuring various countries to restrict their commercial relations with Havana. To combat this, we believe the Cubans will attempt to play on Western sentiment that economic ties will help "wean" Havana from its dependence on the USSR. The Castro regime also is likely to try to project an image of reasonableness by renewing its calls for broad negotiations to resolve the Central American crisis. 25X1 25X1

Because Cuba is likely to miss the targets set by the creditors' task force, the nations whose banks are involved may be more receptive to Washington's calls for stricter terms in the next rescheduling sessions. If significantly harsher terms appear likely, Fidel Castro may try to intimidate Western creditors by drumming up a major campaign among nonaligned nations for an international debt moratorium. He has occasionally raised this issue, most recently during his speech at the Nonaligned Summit in New Delhi last March. 25X1 25X1

As Cuba's economic difficulties mount, the probability for heightened tensions with the United States will increase. Over the years, Castro has repeatedly deflected the blame for his serious domestic problems to Washington. In the past, he has managed to stimulate popular enthusiasm with diatribes against the United States. For example, in May 1970 he called a mass rally before the then-empty US Embassy following the kidnaping of several Cuban fishermen by an exile group. After whipping up public emotions with a fiery anti-US speech, Castro announced the devastating news that the enormous campaign to harvest 10 million tons of sugar had failed to meet its goals. 25X1

In recent years, however, such appeals have become increasingly ineffective and the Cuban leader may feel compelled to manufacture a crisis with Washington for his own credibility. We cannot reliably predict

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[6] While Cuba recently announced that its aid from Moscow increased by 20 percent in 1982 over 1981, and will increase again (by an unspecified amount) this year, we believe that in future negotiations for aid, Cuban requests will be more carefully scrutinized by the USSR. Moreover, subsidy levels swing with the world market prices of sugar and oil. Accordingly, the oil price decline will reduce the nominal value of the oil subsidy for this year.

what form such a crisis might take, but options could include deliberate interference with US commercial radiobroadcasts, violations of US air traffic regulations by Cuban commercial aircraft, or a major diplomatic campaign against renewed US reconnaissance overflights.

Rather than place pressure on Castro to reduce overseas adventures such as those in Sub-Saharan Africa, Cuba's economic difficulties will further stimulate these activities. We believe this because:

- Large numbers of civilian or military personnel stationed abroad reduce the island's labor surplus.
- Many of these individuals earn hard currency for Cuba.

Indeed, Havana's reluctance to agree to a major withdrawal from Angola, for example, is likely to grow as economic problems mount, for sudden return of these thousands of troops, many of whom are reservists, could have serious domestic employment repercussions.

Nevertheless, Cuba's hard currency difficulties may force some cutbacks in its foreign assistance. For example, the construction of a sugar mill in Nicaragua apparently has been delayed because of material shortages. In addition, the US Interests Section reported that Cuba no longer will provide stipends for foreign students and now is requiring the home nation to deposit—in hard currency—return airfare with Havana.

In our judgment, however, Cuba's crisis will not dampen Castro's willingness to support insurgent groups in Central America or to help nascent radical regimes such as the Bouterse dictatorship in Suriname, largely because the hard currency costs of these adventures have proved small. 25X1

Cuba's hard currency shortages will push the island toward even greater dependence on the USSR and deeper integration into the Soviet Bloc economic system. As Havana's dependence on Moscow grows, Castro will have less room for manuever against Soviet demands. Thus, we believe that he will be under increasing pressure to comply should the USSR decide that Cuban troops are necessary to help stabilize yet another friendly regime in Africa. 25X1

Over the Longer Term

Unless Cuba secures enough foreign funding to support a dramatic economic turnaround, the Castro regime faces serious problems for the second half of this decade. By 1985, the postponement of capital investment will be taking a substantial toll on the growth of output. At about the same time, the surge of new entrants into the labor market will reach record levels, a situation that will continue until the early 1990s. 25X1

Should popular dissatisfaction with living and employment conditions reach significant proportions, Castro could once again induce large-scale emigration—a tactic he used successfully in the mid-1960s and again in 1980 with the Mariel exodus. Because the effect of growth and employment trends will cumulate slowly, we believe that Havana will be more likely to use the emigration option toward the end of the decade. 25X1 25X1

Cuba's inability to get its economic house in order could also lead to a Soviet move to demand greater control over economic activities on the island, as it did in the early 1970s, when overly zealous Cuban economic policies led to serious dislocations. The probability of such an action would rise sharply if Havana shows signs of being unable to begin repayments of its over $7 billion soft currency debt to the USSR, scheduled to begin in 1986. 25X1 25X1

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